

For example, gross investment income includes amounts received as commitment fees, as a bonus for the entering into of a lease, or as a penalty for the early payment of a mortgage.

(2) In the case of a taxable year beginning after December 31, 1958, the amount (if any) by which the net short-term capital gain (as defined in section 1222(5)) exceeds the net long-term capital loss (as defined in section 1222(8)), and

(3) The gross income from any trade or business (other than an insurance business) carried on by the life insurance company, or by a partnership of which the life insurance company is a partner.

(b) *No double inclusion of income.* In computing the gross income from any trade or business (other than an insurance business) carried on by the life insurance company, or by a partnership of which the life insurance company is a partner, any item described in section 804(b)(1) and paragraph (a)(1) of this section shall not be considered as gross income arising from the conduct of such trade or business or partnership, but shall be taken into account under section 804(b)(1) and paragraph (a)(1) of this section.

(c) *Exclusion of net long-term capital gains.* Any net long-term capital gains from the sale or exchange of a capital asset (or any gain considered to be from the sale or exchange of a capital asset under applicable law) shall be excluded from the gross investment income of a life insurance company. However, section 804(b)(2) and paragraph (a)(2) of this section provide that the amount (if any) by which the net short-term capital gain exceeds the net long-term capital loss shall be included in the gross investment income of a life insurance company.

[T.D. 6513, 25 FR 12661, Dec. 10, 1960]

§ 1.804-4 Investment yield of a life insurance company.

(a) *Investment yield defined.* Section 804(c) defines the term “investment yield” of a life insurance company for purposes of part I, subchapter L, chapter 1 of the Code. Investment yield means gross investment income (as defined in section 804(b) and paragraph (a) of § 1.804-3), less the deductions pro-

vided in section 804(c) and paragraph (b) of this section for investment expenses, real estate expenses, depreciation, depletion, and trade or business (other than an insurance business) expenses. However, such expenses are deductible only to the extent that they relate to investment income and the deduction of such expenses is not disallowed by any other provision of title A of the Code. For example, investment expenses are not allowable unless they are ordinary and necessary expenses within the meaning of section 162, and under section 265, no deduction is allowable for interest on indebtedness incurred or continued to purchase or carry obligations the interest on which is wholly exempt from taxation under chapter 1 of the Code. A deduction shall not be permitted with respect to the same item more than once.

(b) *Deductions from gross investment income—(1) Investment expenses.* (i) Section 804(c)(1) provides for the deduction of investment expenses by a life insurance company in determining investment yield. “Investment expenses” are those expenses of the taxable year which are fairly chargeable against gross investment income. For example, investment expenses include salaries and expenses paid exclusively for work in looking after investments, and amounts expended for printing, stationery, postage, and stenographic work incident to the collection of interest. An itemized schedule of such expenses shall be attached to the return.

(ii) Any assignment of general expenses to the investment department of a life insurance company for which a deduction is claimed under section 804(c)(1) subjects the entire deduction for investment expenses to the limitation provided in that section and subdivision (iii) of this subparagraph. As used in section 804(c)(1), the term *general expenses* means any expense paid or incurred for the benefit of more than one department of the company rather than for the benefit of a particular department thereof. For example, if real estate taxes, depreciation, or other expenses attributable to office space owned by the company and utilized by it in connection with its investment function are assigned to investment expenses, such items shall be deductible

as general expenses assigned to or included in investment expenses and as such shall be subject to the limitation of section 804(c)(1) and subdivision (iii) of this subparagraph. Similarly, if an expense, such as a salary, is attributable to more than one department, including the investment department, such expense may be properly allocated among these departments. If such expenses are allocated, the amount properly allocable to the investment department shall be deductible as general expenses assigned to or included in investment expenses and as such shall be subject to the limitation of section 804(c)(1) and subdivision (iii) of this subparagraph. If general expenses are in part assigned to or included in investment expenses, the maximum allowance (as determined under section 804(c)(1)) shall not be granted unless it is shown to the satisfaction of the district director that such allowance is justified by a reasonable assignment of actual expenses. The accounting procedure employed is not conclusive as to whether any assignment has in fact been made. Investment expenses do not include Federal income and excess profits taxes, if any. In cases where the investment expenses allowable as deductions under section 804(c)(1) exceed the limitation contained therein, see section 809(d)(9).

(iii) If any general expenses are in part assigned to or included in investment expenses, the total deduction under section 804(c)(1) shall not exceed the sum of:

(a) One-fourth of one percent of the mean of the assets (as defined in section 805(b)(4) and paragraph (a)(4) of §1.805-5) held at the beginning and end of the taxable year,

(b) The amount of the mortgage service fees for the taxable year, plus

(c) Whichever of the following is the greater:

(I) One-fourth of the amount by which the investment yield (computed without any deduction for investment expenses allowed by section 804(c)(1)) exceeds 3 3/4 percent of the mean of the assets (as defined in section 805(b)(4)) held at the beginning and end of the taxable year, reduced by the amount of the mortgage service fees for the taxable year, or

(2) One-fourth of one percent of the mean of the value of mortgages held at the beginning and end of the taxable year for which there are no mortgage service fees for the taxable year. For purposes of the preceding sentence, the term *mortgages held* refers to mortgages, and other similar liens, on real property which are held by the company as security for "mortgage loans". For purposes of section 804(c)(1)(B) and (C)(i) and (b) and (c)(I) of this subdivision, the term *mortgage service fees* includes mortgage origination fees. Such mortgage origination fees shall be amortized in accordance with the rules prescribed in section 818(b) and the regulations thereunder.

(iv) The operation of the limitation contained in section 804(c)(1) and subdivision (iii) of this subparagraph may be illustrated by the following example:

Example. The books of S, a life insurance company, reflect the following items for the taxable year 1958:

Investment expenses (including general expenses assigned to or included in investment expenses)	\$125,000
Mean of the assets held at the beginning and end of the taxable year	20,000,000
Mortgage service fees	25,000
Investment yield computed without regard to investment expenses	1,200,000
Mean of the value of mortgages held at the beginning and end of the taxable year for which there are no mortgage service fees ..	6,000,000

In order to determine the limitation on investment expenses, S would make up the following schedule:

1. Mean of the assets held at the beginning and end of the taxable year	\$20,000,000
2. One-fourth of 1 percent of item 1 (1/4 of 1% of \$20,000,000)	50,000
3. Mortgage service fees	25,000
4. The greater of (a) or (b):	
(a)(i) Investment yield computed without regard to investment expenses	\$1,200,000
(ii) Three and three-fourths percent of item 1 (33/4% × \$20,000,000)	750,000
(iii) Excess of (i) over (ii) (\$1,200,000 minus \$750,000)	450,000
(iv) One-fourth of (iii) (1/4 × \$450,000)	112,500
(v) Less: Mortgage service fees (item 3)	25,000
(vi) Excess of (iv) over (v) (\$112,500 minus \$25,000)	87,500

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(b) One-fourth of 1 percent of the mean of the value of mortgages held at the beginning and end of the taxable year for which there are no mortgage service fees (1/4 of 1% × \$6,000,000)	15,000	
5. The greater of item 4 (a) or (b)		87,500
6. Limitation on investment expenses (items 2, 3, and 4(a))		162,500

As the investment expenses (including general expenses assigned to or included in investment expenses) of S for the taxable year 1958 (\$125,000) do not exceed the limitation on such expenses (\$162,500), S would be entitled to deduct the entire \$125,000 under section 804(c)(1).

(2) *Real estate expenses and taxes.* The deduction for expenses and taxes under section 804(c)(2) includes taxes (as defined in section 164) and other expenses for the taxable year exclusively on or with respect to real estate owned by the company. For example, no deduction shall be allowed under section 804(c)(2) for amounts allowed as a deduction under section 164(e) (relating to taxes of shareholders paid by a corporation). No deduction shall be allowed under section 804(c)(2) for any amount paid out for new buildings, or for permanent improvements or betterments made to increase the value of any property. An itemized schedule of such taxes and expenses shall be attached to the return. See subparagraph (4) of this paragraph for limitation of such deduction.

(3) *Depreciation.* The deduction allowed for depreciation is, except as provided in section 804(c)(3) and subparagraph (4) of this paragraph, identical to that allowed other corporations by section 167. Such amount allowed as a deduction from gross investment income in determining investment yield is limited to depreciation sustained on the property used, and to the extent used, for the purpose of producing the income specified in section 804(b). An election with respect to any of the methods of depreciation provided in section 167 shall not be affected in any way by the enactment of the Life Insurance Company Income Tax Act of 1959 (73 Stat. 112). However, in appropriate cases, the method of depreciation may be changed with the consent of the Commissioner. See section 167(e) and § 1.167(e)-1. See subparagraph (4) of this paragraph for limitation of such deduction. See section

809(d)(12) and the regulations thereunder for the treatment of depreciable property used in the operation of a life insurance business.

(4) *Limitation on deductions allowable under section 804 (c)(2) and (c)(3).* Section 804(c)(3) provides that the amount allowable as a deduction for taxes, expenses, and depreciation on or with respect to any real estate owned and occupied for insurance purposes in whole or in part by a life insurance company shall be limited to an amount which bears the same ratio to such deduction (computed without regard to this limitation) as the rental value of the space not so occupied bears to the rental value of the entire property. For example, T, a life insurance company, owns a twenty-story downtown home office building. The rental value of each floor of the building is identical. T rents nine floors to various tenants, one floor is utilized by it in operating its investment department, and the remaining ten floors are occupied by it in carrying on its insurance business. Since floor space equivalent to eleven-twentieths, or 55 percent, of the rental value of the entire property is owned and occupied for insurance purposes by the company, the deductions allowable under section 804(c)(2) and (3) for taxes, depreciation, and other real estate expenses shall be limited to nine-twentieths, or 45 percent, of the taxes, depreciation, and other real estate expenses on account of the entire property. However, the portion of such allowable deductions attributable to the operation of the investment department (one-twentieth, or 5 percent) may be deductible as general expenses assigned to or included in investment expenses and as such shall be subject to the limitations of section 804(c)(1). Where a deduction is claimed as provided in this section, the parts of the property occupied and the parts not occupied by the company in carrying on its insurance business, together with the respective rental values thereof, must be shown in a schedule accompanying the return.

(5) *Depletion.* The deduction for depletion (and depreciation) provided in section 804(c)(4) is identical to that allowed other corporations by section 611. The amount allowed by section 611

in the case of a life insurance company is limited to depletion (and depreciation) sustained on the property used, and to the extent used, for the purpose of producing the income specified in section 804(b). See section 611 and §1.611-5 for special rules relating to the depreciation of improvements in the case of mines, oil and gas wells, other natural deposits, and timber.

(6) *Trade or business deductions.* (i) Under section 804(c)(5), the deductions allowed by subtitle A of the Code (without regard to this part) which are attributable to any trade or business (other than an insurance business) carried on by the life insurance company, or by a partnership of which the life insurance company is a partner are, subject to the limitations in subdivisions (ii), (iii), and (iv) of this subparagraph, allowable as deductions from the gross investment income of a life insurance company in determining its investment yield. Such deductions are allowable, however, only to the extent that they are attributable to the production of income which is included in the life insurance company's gross investment income by reason of section 804(b)(3). However, since any interest, dividends, rents, and royalties received by any trade or business (other than an insurance business) carried on by the life insurance company, or by a partnership of which the life insurance company is a partner, is included in the life insurance company's gross investment income by reason of section 804(b)(1) and paragraph (b) of §1.804-3, any expenses fairly chargeable against the production of such income may be deductible under section 804(c) (1), (2), (3), or (4). The allowable deductions may exceed the gross income from such business.

(ii) In computing the deductions under section 804(c)(5), there shall be excluded losses:

(a) From (or considered as from) sales or exchanges of capital assets,

(b) From sales or exchanges of property used in the trade or business (as defined in section 1231(b)), and

(c) From the compulsory or involuntary conversion (as a result of destruction, in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat

or imminence thereof) of property used in the trade or business (as so defined).

(iii) Any item, to the extent attributable to the carrying on of the insurance business, shall not be taken into account. For example, if a life insurance company operates a radio station primarily to advertise its own insurance services, a portion of the expenses of the radio station shall not be allowed as a deduction. The portion disallowed shall be an amount which bears the same ratio to the total expenses of the station as the value of advertising furnished to the insurance company bears to the total value of services rendered by the station.

(iv) The deduction for net operating losses provided in section 172, and the special deductions for corporations provided in part VIII, subchapter B, chapter 1 of the Code, shall not be allowed.

[T.D. 6513, 25 FR 12662, Dec. 10, 1960]

§ 1.806-1 Adjustment for certain reserves.

(a) For taxable years beginning after December 31, 1953, but before January 1, 1955, and ending after August 16, 1954, a life insurance company writing contracts other than life insurance or annuity contracts (either separately or combined with noncancellable health and accident insurance contracts) must add to its life insurance company taxable income (as a factor in determining 1954 adjusted taxable income) an amount equal to eight times the amount of the adjustment for certain reserves provided in paragraph (b) of this section.

(b) The adjustment for certain reserves referred to in paragraph (a) of this section shall be an amount equal to 3 1/4 percent of the mean of the unearned premiums and unpaid losses at the beginning and end of the taxable year on such other contracts as are not included in life insurance reserves. If such unearned premiums, however, are less than 25 percent of the net premiums written during the taxable year on such other contracts, then the adjustment shall be 3 1/4 percent of 25 percent of the net premiums written during the taxable year on such other contracts plus 3 1/4 percent of the mean of the unpaid losses at the beginning